

Report of the auditor-general to the Eastern Cape Provincial Legislature and the council on the Inxuba Yethemba Municipality

Report on the financial statements

Introduction

1. I was engaged to audit the financial statements of the Inxuba Yethemba Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2015, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget information with actual information for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2014 (Act No. 10 of 2014) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with International Standards on Auditing (ISA). Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

4. I was unable to obtain sufficient appropriate audit evidence regarding the financial statements as a whole, as the financial statements were presented for audit purposes without accurate and complete underlying accounting records. I was unable to audit the financial statements by alternative means. Consequently, I was unable to determine whether any adjustments relating to the financial statements as a whole were necessary.

Disclaimer of opinion

5. Because of the significance of the matter described in the basis for disclaimer of opinion paragraph, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matters

6. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Unauthorised expenditure

7. As disclosed in note 49 to the financial statements, unauthorised expenditure of R19,1 million was incurred in the current year due to the municipality not monitoring the implementation of the budget, as required by the MFMA.

Irregular expenditure

8. As disclosed in note 51 to the financial statements, irregular expenditure of R1,3 million (2013-14: R4,8 million) was incurred in the current year due to the municipality not adhering to supply chain management (SCM) regulations and procedures.

Fruitless and wasteful expenditure

9. As disclosed in note 50 to the financial statements, fruitless and wasteful expenditure of R1,1 million was incurred in the current year due to the municipality not adhering to MFMA requirements regarding the payment of creditors.

Additional matters

10. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Withdrawal from the audit engagement

11. Due to the limitation imposed on the scope of the audit by management, I have disclaimed my opinion on the financial statements. But for the legislated requirement to perform the audit of the municipality, I would have withdrawn from the engagement in terms of the ISAs.

Unaudited disclosure notes

12. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with this legislation. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion thereon.

Report on other legal and regulatory requirements

13. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading, but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

14. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2015:
- Basic infrastructure development and services, on pages ... to ...
 - Community services, on pages ... to ...
 - Local economic development, on pages ... to ...
15. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
16. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development priorities. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
17. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
18. The material findings in respect of the selected development priorities are as follows:

Basic infrastructure development and services

Usefulness of reported performance information

Consistency of objectives, indicators and targets

19. Section 41(c) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 24% of the reported objectives, 69% of the reported indicators and 100% of the reported targets were not consistent with those in the approved service delivery and budget implementation plan. This was due to management reporting on additional key performance objectives, indicators and targets in the annual performance report that were not included in the municipality's service delivery and budget implementation plan.

20. Section 54(1)(c) of the MFMA determines that the service delivery and budget implementation plan adopted by the municipal council may be amended only if the council approves an adjustments budget. Changes to the service delivery and budget implementation plan in the year have to be made in accordance with the process as prescribed per section 28 of the MFMA. However, material changes were made to the objectives, indicators and targets in the annual performance report, without following the process as prescribed in section 28 of the MFMA and without adoption by the municipal council. This was due to management reporting on additional key performance objectives, indicators and targets in the annual performance report that were not included in the municipality's service delivery and budget implementation plan.

Reliability of reported performance information

21. The FMPPi requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the absence of information systems, the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information, and the auditee's records not permitting the application of alternative audit procedures.

Community services

Usefulness of reported performance information

Consistency of objectives, indicators and targets

22. Section 41(c) of the MSA requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 47% of the reported objectives, 35% of the reported indicators and 91% of the reported targets were not consistent with those in the approved service delivery and budget implementation plan. This was due to management reporting on an additional key performance objective and target in the annual performance report that was not included in the municipality's service delivery budget and implementation plan.
23. Section 54(1)(c) of the MFMA determines that the service delivery and budget implementation plan adopted by the municipal council may be amended only if the council approves an adjustments budget. Changes to the service delivery and budget implementation plan in the year have to be made in accordance with the process as prescribed per section 28 of the MFMA. However, material changes were made to the objectives, indicators and targets in the annual performance report, without following the process as prescribed in section 28 of the MFMA and without adoption by the municipal council. This was due to management reporting on additional key performance objectives, indicators and targets in the annual performance report that were not included in the municipality's service delivery and budget implementation plan.

Measurability of targets

24. Performance targets should be specific in clearly identifying the nature and required level of performance, measurable and time bound, as required by the FMPPI. A total of 29% of the significantly important targets in relation to the primary function of the municipality were not specific, measurable and time bound. This was because although management was aware of the requirements of the FMPPI, they had not implemented appropriate systems and processes and did not exercise due care to enable the application of the principles in the FMPPI.

Reliability of reported performance information

25. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the absence of information systems, the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information, and the auditee's records not permitting the application of alternative audit procedures.

Local economic development

Usefulness of reported performance information

Consistency of objectives, indicators and targets

26. Section 41(c) of the MSA requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 76% of the reported objectives, 34% of the reported indicators and 39% of the reported targets were not consistent with those in the approved service delivery and budget implementation plan. This was due to management amending the wording used in the annual performance report as well as including additional key performance indicators and targets in the annual performance report.
27. Section 54(1)(c) of the MFMA determines that the service delivery and budget implementation plan adopted by the municipal council may be amended only if the council approves an adjustments budget. Changes to the service delivery and budget implementation plan in the year have to be made in accordance with the process as prescribed per section 28 of the MFMA. However, material changes were made to the objectives in the annual performance report, without following the process as prescribed in section 28 of the MFMA and without adoption by the municipal council. This was due to management reporting on additional key performance objectives in the annual performance report that were not included in the municipality's service delivery and budget implementation plan.

Measurability of indicators

28. Performance indicators should be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use, as required by the FMPPI. A total of 38% of the significantly important indicators in relation to the primary function or purpose of the municipality were not well defined. The processes and systems that produced the indicator should also be verifiable, as required by the FMPPI. A total of 31% of the significantly important indicators in relation to the primary function or purpose of the municipality were not verifiable. This was because although management was aware of the requirements of the FMPPI, they had not implemented appropriate systems and processes and did not exercise due care to enable the application of the principles in the FMPPI.

Reliability of reported performance information

29. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the absence of information systems, the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information, and the auditee's records not permitting the application of alternative audit procedures.

Additional matters

30. I draw attention to the following matters:

Achievement of planned targets

31. Refer to the annual performance report on pages x to x for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on usefulness and reliability of the reported performance information for the selected development priorities in paragraphs 19 to 29 of this report.

Unaudited supplementary schedules

32. The supplementary information set out on pages xx to xx does not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not report thereon.

Compliance with legislation

33. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Annual report and annual financial statements

34. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors in the submitted financial statements were not corrected and the supporting records could not subsequently be provided, which resulted in the financial statements receiving a disclaimer of audit opinion.
35. Consolidated financial statements were not submitted for auditing within three months after the end of the financial year, as required by section 126(1)(b) of the MFMA.
36. Consolidated annual financial statements were not prepared, as required by section 122(2) of the MFMA.
37. The non-submission of the annual financial statements to the auditor-general for auditing was not appropriately addressed by the mayor and the municipal council, as required by section 133(1) of the MFMA.

Asset management

38. An adequate management, accounting and information system was not in place to account for assets, as required by section 63(2)(a) of the MFMA.
39. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.
40. The municipality did not establish an investment policy that was adopted by council, as required by section 13(2) of the Municipal Finance Management Act and Municipal investment regulation 3(1)(a)

Consequence management

41. Unauthorised, irregular as well as fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person was liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.
42. The condonation of irregular expenditure was not approved by the appropriate relevant authority, as required by sections 1 and 170 of the MFMA.

Expenditure management

43. Sufficient appropriate audit evidence could not be obtained that money owed by the municipality had always been paid within 30 days, as required by section 65(2)(e) of the MFMA.
44. Sufficient appropriate audit evidence could not be obtained that payments from the municipality's bank account had been approved by the accounting officer or a properly authorised official, as required by section 11(1) of the MFMA.
45. An effective system of expenditure control (including procedures for the approval, authorisation, withdrawal and payment of funds) was not in place, as required by section 65(2)(a) of the MFMA.

46. An adequate management, accounting and information system was not in place to account for creditors, as required by section 65(2)(b) of the MFMA.
47. Reasonable steps were not taken to prevent unauthorised, irregular as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Liability management

48. An adequate management, accounting and information system was not in place to account for liabilities, as required by section 63(2)(a) of the MFMA.
49. An effective system of internal control for liabilities (including a liability register) was not in place, as required by section 63(2)(c) of the MFMA.

Revenue management

50. An adequate management, accounting and information system was not in place to account for receipts of revenue, as required by section 64(2)(e) of the MFMA.
51. An effective system of internal control for debtors was not in place, as required by section 64(2)(f) of the MFMA.
52. Sufficient appropriate audit evidence could not be obtained that revenue due to the municipality had been calculated on a monthly basis, as required by section 64(2)(b) of the MFMA.
53. Sufficient audit evidence could not be obtained that interest had been charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.
54. A credit-control and debt-collection policy was not adopted, as required by section 96(b) of the MSA and section 62(1)(f)(iii) of MFMA.

Conditional grants and transfers

55. The municipality did not evaluate its performance in respect of programmes or functions funded by the municipal infrastructure grant, municipal systems improvement grant and local government financial management grant allocation, as required by section 12(5) of DoRA.

Procurement and contract management

56. Sufficient appropriate audit evidence could not be obtained that all contracts had been awarded in accordance with the legislative requirements and a procurement process that is fair, equitable, transparent and competitive, as all requested documentation could not be provided due to a poor document management system.
57. Sufficient appropriate audit evidence could not be obtained that goods and services with a transaction value below R200 000 had been procured by means of obtaining the required price quotations, as required by supply chain management (SCM) regulation 17(a) and (c).
58. Quotations were accepted from prospective providers who are not registered on the list of accredited prospective providers and do not meet the listing requirements prescribed by the SCM policy, in contravention of SCM regulations 16(b) and 17(b).

59. Sufficient appropriate audit evidence could not be obtained that bid specifications had been drafted by bid specification committees composed of one or more officials of the municipality, as required by SCM regulation 27(3).
60. Sufficient appropriate audit evidence could not be obtained that invitations for competitive bidding had been advertised for the required minimum period, as required by SCM regulation 22(1) and 22(2).
61. Sufficient appropriate audit evidence could not be obtained that bids had been evaluated by bid evaluation committees composed of officials from the departments requiring the goods or services and at least one SCM practitioner of the municipality, as required by SCM regulation 28(2).
62. Sufficient appropriate audit evidence could not be obtained that bid adjudication had always been done by committees composed in accordance with SCM regulation 29(2).
63. Sufficient appropriate audit evidence could not be obtained that construction contracts had been awarded to contractors that were registered with the Construction Industry Development Board (CIDB) and qualified for the contract in accordance with section 18(1) of the CIDB Act of South Africa, 2000 (Act No. 38 of 2000) (CIDB Act) and CIDB regulations 17 and 25(7A).
64. Sufficient appropriate audit evidence could not be obtained that contracts and quotations had only been awarded to providers whose tax matters have been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.
65. Sufficient appropriate audit evidence could not be obtained that contracts had only been extended or modified after tabling the reasons for the proposed amendment in the council of the municipality, as required by section 116(3) of the MFMA.
66. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
67. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, contrary to section 116(2)(c) of the MFMA.

Human resource management

68. An approved staff establishment was not in place, as required by section 66(1)(a) of the MSA.
69. Sufficient appropriate audit evidence could not be obtained that job descriptions were established for all posts in which appointments were made in the current year, as required by section 66(1)(b) of MSA.
70. An acting CFO was appointed for a period of more than three months without the approval by the MEC or for more than six months in contravention of section 54A(2A) of the MSA.

Strategic planning and performance management

71. Revisions to the service delivery and budget implementation plan were not approved by the council after the approval of the adjustments budget, as required by section 54(1)(c) of the MFMA.

72. The performance of the municipality was not assessed during the first half of the financial year, as required by section 72(1)(a)(ii) of the MFMA.
73. The annual performance report for the year under review did not include the performance of the municipality and each external service provider, a comparison of the performance with set targets, a comparison with the previous financial year as well as measures taken to improve performance, as required by section 46(1)(a)(b) and (c) of the MSA.
74. The municipality did not establish a performance management system, as required by section 38(a) of the MSA.
75. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.

Internal control

76. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the disclaimer of opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report

Leadership

77. The leadership did not fulfil its oversight responsibilities with regard to the implementation and monitoring of internal controls and compliance with laws and regulations, and did not insist on daily disciplines to ensure sound financial and performance management and compliance with laws and regulations. The slow response by the accounting officer and management to the AGSA's messages of the previous audit has contributed to the repeat material misstatements in the financial statements and non-compliance with laws and regulations.
78. Although there was no change in leadership, the municipality has not improved from the prior year. Notwithstanding the consistency in leadership, there was a lack of oversight and accountability, and together with management's failure to adequately respond to prior year internal and external audit findings, this resulted in a number of repeat audit findings.
79. Oversight responsibilities regarding the monitoring of internal controls over financial reporting and compliance with applicable laws and regulations were not adequately performed. This resulted in material misstatements to the annual financial statements submitted for auditing, non-compliance with applicable laws and regulations as well as information presented in the report on predetermined objectives not being valid, accurate and complete.

Financial and performance management

80. The financial statements and supporting accounting file submitted for audit purposes contained numerous limitations and deficiencies as assessed during my high-level review. This was due to weaknesses identified in the record keeping of the municipality in that recorded transactions did not always have adequate supporting documentation and underlying supporting schedules required for audit purposes. The lack of the

adequate review of the financial statements and supporting documentation prior to submission of the annual financial statements further contributed to the deficiencies noted.

81. The systems or processes used for the preparation and reporting of performance against predetermined objectives were not adequate, as the municipality had not formally adopted, and tailored, a system or procedure manual that sets out processes to follow, controls that must be in place, as well as responsible officials for the preparation, collation, reporting and monitoring of performance against predetermined objectives.

Governance

82. Insufficient action was taken by the governance structures within the municipality during the year under review to ensure that risks relating to the monitoring and reporting of financial information as well as performance objectives were addressed. Management failed to implement the recommendations of the internal audit unit, which resulted in external audit findings in the current year. This also contributed to repeat audit findings in a number of areas.
83. The municipality had an audit committee and internal audit unit, and the audit committee held regular meetings as required by the MFMA. However, the audit committee's ability to provide assurance was limited due to the inadequacy of the financial reports provided for their review.

Auditor-General

East London

30 November 2015



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence